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Outlook for the Economy and Real Estate

REALTOR®

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The Outlook For the Economy and Real Estate

The economy grew at a modest rate of 2.4 percent after adjusting for inflation in the third quarter. Most of this growth can be attributed to significant gains in consumption. Developments in the automobile industry played a major role in boosting overall consumption in that period and will also impact the level of production in the fourth quarter. In fact, the third quarter figure would have been stronger had there not been a further deterioration in the trade deficit. While the near-term forecast remains positive with fourth-quarter real growth expected to increase about 3.0 percent, this rebound will be both modest and short-lived. By next year, the combination of tax reform, an aging recovery and fiscal restraint associated with Gramm Rudman Hollings will slow the expansion to under a 2 percent annual rate.

The following are highlights from the third quarter:

	Contribution to GNP Growth (Percentage Points)
o Consumption spending increased at a strong rate of 38 percent from the second quarter buoyed by cut-rate auto financing. However, because the rise in car sales was largely offset by a drop in inventories, it did not lead to an increase in production and, therefore, its impact on real output growth was diluted.	4.7
o Residential Investment, while remaining at healthy levels, has slowed from the brisk pace experienced earlier this year. The largest contributor to the slow down has been the dampening in construction of multi-family units due to removal of many investment incentives in this area.	0.4
o Nonresidential Investment was nearly flat in the third quarter. However, the composition of investment was distorted by tax reform. Investment in equipment increased modestly in the third quarter as many manufacturers are trying to take advantage of the transition rules. Investment in non-residential structures continued to decline in the third quarter reflecting vacancy rates at double digit levels, thereby, subtracting 0.3 percentage points from GNP growth.	0.0
o Inventories fell in the third quarter as auto makers attempted to clear out their lots of 1986 models through cut rate financing incentives. The decline in inventories subtracted over two percentage points from GNP growth.	-2.1
o Net Export growth continued to decline in the third quarter leading to a widening of the trade deficit. The 15 percent real increase in exports was absorbed by a 20 percent increase in imports. As a result, the foreign trade sector subtracted over 1 percentage point from GNP growth in the third quarter. However, recent monthly data suggest that this trend in export growth should soon be reversed.	-1.2

- o Government Purchases increased modestly in the third quarter contributing little to GNP growth. However, government purchases are expected to rebound during the fourth quarter due, in large part, to increases in Commodity Credit Corporation (CCC) purchases. The CCC is a federal program whereby the Federal government purchases crops at support prices. 0.7

The economy has been growing fitfully for the last 2 and 1/2 years and appears likely to continue to do so for the next year. The major stimulus to growth next year will be a long-awaited rebound in net export growth. Recently, the declining value of the dollar has had some limited positive impact on the nation's trade performance as evidenced by two consecutive monthly declines in the trade deficit. However, those sectors that previously provided strength, consumption and housing, will not be be able to sustain the recovery as they have in the past. Increases in personal income are expected to remain sluggish and a growing level of consumer debt will likely dampen overall spending in 1987. Less spending by the consumer, lower levels of investment due to tax reform, and reduced levels of governnent spending will likely hold real growth in 1987 GNP to below 2 percent for the entire year.

The outlook for inflation in both 1986 and 1987 remains very favorable. The inflation rate for all of 1986, as measured by the Consumer Price Index (CPI), will likely be below 2 percent--the lowest level in 20 years. In 1987, the key influences on inflation will be the depreciation of the dollar, the effect of the increased slack in labor and product markets, and some further softenening of oil prices in the first half of the year. While the depreciation of the dollar will boost inflation, moderate wage demands and the weakness in oil prices will tend to soften this effect. As a result, overall inflation is expected to increase at a modest 3.5 percent rate next year.

Interest rates remain quite volatile reflecting investor jitters over the political and economic outlook. The bond market remains somewhat nervous about the current strength in economic activity, possibilities of renewed inflation due to rising oil prices, and the potential effects of a depreciating dollar on foreign investor appetites for U.S. securities. However, it is doubtful that many of these fears will be fully realized over the next year. Any anticipated growth in economic activity will be both modest and temporary. While oil prices are expected to begin to rise by late this year, lower unit labor costs should continue to put downward pressure on overall prices. Finally, the Japanese press report that the Bank of Japan is considering a cut in the discount rate is good news for U.S. interest rates. A reduction in Japan's interest rate could make U.S. securities more attractive to Japanese investors. It would also give the federal reserve greater leeway to ease credit conditions. Therefore, for these reasons, interest rates are expected to slowly trend downward next year. Long-term interest rates are expected to reach 7 percent and short term rates should dip below 5 percent.

Real Estate Markets

Over the past year, the housing market has been one of the few bright spots in an otherwise sluggish economy. The strength in housing can be attributed to an expected annual average mortgage rate of 10.0 percent in 1986 -- the lowest level this decade. This year alone, over 3.4 million existing homes are expected to be sold and over 1.2 million single-family homes are expected to be started, making it the best year for housing since 1979.

Lower interest rates are expected to keep sales of existing homes at healthy levels throughout next year. In 1987, existing homes are expected to continue to be sold at a healthy pace of 3.4 million units. However, slower growth and tax reform will dilute the positive impact of lower mortgage interest rates on new residential construction. Residential investment will follow two distinct paths. Slower growth in the economy will lead to a modest decline in construction of single-family homes with about 6 percent fewer homes expected to be started in 1987. In contrast, construction of multi-family housing will be adversely affected by tax reform and these units are expected to decline by as much as 25 percent in 1987.

Table 1 November 1986

U.S. ECONOMIC OUTLOOK

	QUARTERS								YEARS				
	Actual		Forecast						Actual		Forecast		
	1986.2	1986.3	1986.4	1987.1	1987.2	1987.3	1987.4	1988.1	1984	1985	1986	1987	1988
AGGREGATE ECONOMY													
Gross National Product (billions of dollars)	4,176	4,234	4,286	4,335	4,376	4,424	4,470	4,525	3,765	3,998	4,211	4,401	4,614
% Change	2.6	5.7	5.0	4.6	3.9	4.5	4.2	5.3	10.5	6.2	5.3	4.5	4.8
% Change (w/out inflation)	0.6	2.4	3.1	1.7	1.4	1.5	1.4	2.2	6.4	2.7	2.6	1.9	2.5
Consumption	6.2	7.2	1.2	1.9	1.3	1.0	0.4	1.0	4.7	3.5	4.0	1.8	2.0
Durables	14.3	38.4	17.2	1.4	0.4	0.2	1.0	2.1	12.7	7.8	6.1	1.5	0.3
Nondurables	8.0	0.8	1.8	1.7	1.3	0.9	0.7	1.6	3.6	1.6	4.0	1.7	1.3
Services	2.6	3.5	2.2	2.2	1.8	1.3	0.7	1.6	3.4	3.7	3.5	2.1	1.4
Residential Investment	14.5	7.2	2.9	2.6	5.9	2.8	1.2	0.9	14.3	3.9	8.6	0.9	0.4
Nonresidential Investment	0.9	2.3	1.2	0.2	2.9	1.1	2.0	0.4	16.9	9.3	0.8	0.6	-0.4
Structures	35.2	9.3	1.8	1.9	1.4	0.7	1.0	0.4	11.1	7.7	11.3	3.6	0.2
Equipment	19.6	1.4	2.4	0.5	4.5	1.8	2.5	0.3	20.0	10.1	4.3	0.7	0.6
Exports	9.8	15.4	3.4	6.9	9.8	10.2	9.9	9.2	6.2	2.0	2.0	7.3	8.8
Imports	15.8	20.0	0.0	0.8	2.3	0.3	1.0	0.5	23.2	3.8	10.7	3.0	0.6
Government Purchases	9.7	3.6	14.2	8.5	0.9	3.7	8.7	7.0	4.0	6.8	3.7	2.5	1.4
Contribution to GNP Growth (Percentage Points)													
Consumption	4.0	4.7	-0.8	1.2	0.8	3.6	0.3	0.7	2.4	2.3	2.5	0.7	1.1
Residential Investment	0.7	0.4	0.2	0.1	-0.3	-0.1	0.1	0.0	0.2	0.4	0.4	-0.1	0.1
Nonresidential Investment	0.1	0.0	0.1	0.0	0.4	0.1	0.2	0.0	1.7	0.8	0.5	0.2	0.1
Structures	1.7	0.3	0.1	0.1	0.0	0.0	0.0	0.0	0.5	0.1	0.6	0.0	0.0
Equipment	1.6	0.4	0.2	0.0	0.4	0.2	0.2	0.0	1.2	0.7	0.1	0.2	0.1
Inventory Change	2.7	2.1	0.8	1.9	0.3	0.5	1.3	1.5	0.2	1.1	0.2	0.1	0.0
Net Exports	3.0	1.2	0.3	0.6	1.3	1.0	0.9	0.9	1.4	1.1	0.8	0.9	0.7
Government Purchases	1.9	0.7	2.8	1.8	0.2	0.7	1.7	1.5	1.5	1.6	0.7	0.2	0.3
Mfg. Capacity Utilization	79.5	79.8	79.9	79.3	78.7	78.2	77.7	77.4	80.8	80.3	79.8	78.5	77.1
Domestic Auto Sales	9.1	9.7	7.2	7.0	7.0	6.9	6.7	6.7	8.0	8.2	8.2	6.9	6.8
Personal Income Per Household	41,985	42,118	42,559	42,874	43,187	43,468	43,809	44,195	38,154	40,285	42,028	43,340	44,858
Percent Change — Year Ago	4.7	3.9	4.0	2.1	2.5	2.1	2.2	2.3	8.6	5.6	4.3	3.1	3.5
Personal Taxes Per Household	6,083	6,238	6,327	6,182	6,250	6,316	6,382	6,111	5,393	5,913	6,165	6,284	6,235
Percent Change — Year Ago	8.6	4.5	3.1	1.6	2.0	1.7	3.2	-2.2	6.2	9.6	4.3	1.9	-0.8
Disposable Personal Income Per Household	35,900	35,880	36,233	36,692	36,937	37,152	37,427	38,084	32,761	34,372	35,863	37,056	38,623
Percent Change — Year Ago	3.9	3.0	3.8	2.2	2.9	2.5	2.0	3.1	3.4	4.9	4.3	3.3	4.2
Employment (millions) (civilian household basis)	109.2	110.0	110.3	110.5	110.7	110.8	111.0	111.1	105.0	107.2	109.6	110.8	111.4
%-Change	1.7	2.8	1.1	0.8	0.5	0.7	0.6	0.2	4.1	2.1	2.2	1.1	0.6
Unemployment Rate (%) (civilian household)	7.2	6.9	7.0	7.1	7.3	7.4	7.5	7.7	7.5	7.2	7.0	7.3	7.7
Consumer Prices (CPI)	1.7	2.6	3.7	3.1	3.1	3.3	3.5	3.4	4.3	3.5	2.0	2.9	3.4
GNP Deflator	1.8	3.6	1.7	2.9	2.5	2.9	2.8	3.2	3.9	3.3	2.7	2.6	2.9
Personal Consumption Inflation	1.1	2.9	3.5	3.1	3.1	3.2	3.4	3.3	3.8	3.5	2.0	2.9	3.3
Residential Construction Inflation	5.6	4.0	2.8	2.5	3.3	3.8	2.9	2.7	4.1	1.8	3.6	3.3	3.2
Nonresidential Const. Inflation	-0.4	2.8	1.8	3.3	3.4	2.9	2.9	3.3	-0.2	0.7	1.4	2.7	3.1
Producer Price Inflation	-5.5	0.4	4.2	4.0	4.1	3.9	3.9	4.0	2.1	0.9	-1.4	3.0	3.9
Before Tax Corporate Profit	231.3	245.9	268.1	265.2	262.7	271.3	276.5	282.2	235.7	223.1	242.4	268.9	294.4
Corporate Tax Liability	93.3	99.2	134.6	126.2	127.3	130.9	132.9	123.4	95.4	91.7	104.0	129.3	127.7
After Tax Profits	138.0	146.7	133.5	139.0	135.4	140.4	143.6	158.8	140.3	131.4	138.4	139.6	166.7
Inventory Valuation Adjustment	10.6	7.1	4.5	4.1	4.8	7.0	7.0	-6.2	-5.5	-9.5	7.4	5.7	-8.3
Capital Consumption Allowance	51.3	50.4	50.6	50.2	49.6	49.1	48.8	48.2	34.5	58.1	52.0	49.4	47.3
Federal Tax Receipts (NIPA)	807.7	826.6	870.4	858.3	867.6	878.5	888.3	867.0	726.5	786.9	826.2	873.1	889.6
% of GNP	19.3	19.5	20.3	19.8	19.8	19.9	19.9	19.2	19.3	19.7	19.6	19.8	19.3
Federal Expenditures (NIPA)	1045.7	1024.0	1059.8	1047.5	1050.0	1061.1	1086.2	1086.1	896.5	984.9	1032.8	1061.2	1110.8
% of GNP	25.0	24.2	24.7	24.2	24.0	24.0	24.3	24.0	23.8	24.6	24.5	24.1	24.1
Deficit(NIPA)	-238.1	-197.4	-189.4	-189.2	-182.4	-182.7	-197.9	-219.1	-170.0	-198.0	-206.6	-188.0	-221.2
% of GNP	-5.7	-4.7	-4.4	-4.4	-4.2	-4.1	-4.4	-4.8	-4.5	-4.9	-4.9	-4.3	-4.8

Source: Forecast produced using Laurence H. Meyer and Associates' model of the U.S. economy
Assumptions and simulations by Dr. Frederick Flick, Janemarie Mulvey, and Sean Burns

Table 2

REAL ESTATE AND FINANCIAL MARKETS

November Iress

	QUARTERS							YEARS				
	Actual		Forecast					Actual		Forecast		
	1986.2	1986.3	1986.4	1987.1	1987.2	1987.3	1987.4	1988.1	1984	1985	1986	1987	1988
REAL ESTATE MARKETS													
Total Single-Family Home Sales (1000's)	4670.5	4784.9	4778.1	4621	4593.3	4541.2	4508.2	4618.5	3932.9	4254.3	4676.5	4565.9	4598.4
(single-family resales and completions)													
Percent Change -- Year Ago	14.5	9.3	5.2	3.3	1.7	5.1	5.6	2.4	4.9	8.2	9.9	2.4	0.7
Existing Single-Family Home Sale(1000's)	3,470	3,616	3,579	3,488	3,469	3,421	3,401	3,464	2,866	3,214	3,481	3,445	3,460
Percent Change -- Year Ago	14.0	7.6	2.3	7.1	0.0	5.4	5.0	1.9	5.5	12.1	8.3	1.0	0.4
Dollar Volume (billions)	349	343	340	332	337	335	330	355	247	291	335	333	351
Existing Home Prices -- Median ($1000's)	82.0	80.2	78.9	81.4	83.9	84.1	82.5	85.9	72.3	75.5	79.8	83.0	86.2
Percent Change -- Year Ago	8.6	4.7	4.9	4.3	2.3	4.9	4.6	4.2	3.6	4.4	5.7	4.0	3.9
Monthly Mortgage Payment (P&I)	587	572	558	545	532	520	519	502	637	609	572	529	514
Percent of Median Family Income	24.8	23.9	22.6	22.5	22.6	22.2	21.3	20.0	28.2	26.2	24.1	22.1	21.1
Housing Starts (1000's)	1,908	1,760	1,788	1,670	1,642	1,650	1,638	1,654	1,763	1,741	1,864	1,650	1,686
Percent Change	9.5	4.3	0.8	-16.4	-14.0	-6.2	-8.4	1.0	3.4	-1.2	7.0	-11.5	2.2
Single-Family Units (1000's)	1,238	1,151	1,189	1,139	1,128	1,140	1,143	1,146	1,100	1,073	1,207	1,137	1,160
Percent Change	15.8	9.8	10.7	-9.1	-8.9	-1.0	-3.8	0.7	3.3	-2.5	12.6	-5.8	2.0
Multi-Family Units (1000's)	670	609	599	532	514	511	494	508	663	669	656	513	527
2-4 Family Units (1000's)	81	77	76	67	65	65	63	64	122	93	84	65	67
Percent Change	20.9	-13.8	-5.0	-34.1	-19.5	-16.2	-17.5	-4.5	7.0	-23.4	-9.9	-22.7	2.7
5+ Family Units (1000's)	590	532	523	464	449	446	432	444	542	576	572	448	463
Percent Change	3.1	-3.2	-15.6	-27.8	-23.9	-16.2	-17.5	-4.5	2.8	6.2	0.6	-21.7	2.8
Mobile Homes Shipped	238	233	244	248	257	268	279	289	295	283	244	263	303
New Single Family Home Sales (1000's)	787	669	635	632	619	602	589	600	637	689	720	610	634
Percent Change -- Year Ago	15.7	-5.9	-8.8	-22.3	-22.2	-11.8	-8.8	-3.6	1.7	8.1	4.6	-15.2	3.9
New Home Prices -- Median ($1000's)	91.4	93.0	94.3	94.4	94.5	94.5	94.5	98.7	80.0	84.3	91.8	94.5	96.4
Percent Change -- Year Ago	8.8	11.5	8.6	6.9	3.4	1.6	0.2	4.4	6.0	5.4	8.9	3.0	2.1
New Home Prices -- Mean ($1000's)	107.8	107.8	110.4	107.6	111.7	111.8	114.6	119.7	96.8	104.0	107.3	111.4	116.1
Percent Change -- Year Ago	3.6	3.4	3.8	4.5	3.6	3.7	3.8	4.4	6.6	7.4	3.1	3.9	4.2
NAR Affordability Index	100.6	104.5	110.2	111.0	110.4	112.5	117.0	125.1	89.1	94.9	103.8	112.7	118.6
Mortgage Debt Outstanding($ billions)	2,389	2,422	2,488	2,556	2,620	2,684	2,748	3,011	1,948	2,202	2,413	2,652	2,911
Housing Inventory (millions)	96.8	97.3	97.7	98.2	98.6	99.0	99.4	101.1	93.4	95.2	97.0	98.8	100.4
Rental Vacancy Rate (%)	7.3	7.1	6.9	6.8	6.7	6.5	6.4	6.0	5.8	6.5	7.1	6.6	6.2
Office Vacancy Rate (%)<1>	16.8	16.8	16.9	17.0	16.8	16.7	16.6	16.4	11.6	14.7	16.5	16.7	16.8
Industrial Vacancy Rate (%) <1>	5.7	5.8	5.7	5.7	5.6	5.6	5.5	5.3	4.9	4.7	5.0	5.6	5.6
FINANCIAL MARKETS													
Money Supply (M1)(% change)	16.8	18.6	12.2	11.8	7.8	7.7	6.5	6.5	7.0	9.1	12.8	11.3	6.7
Velocity of M1 (% change)	-12.2	-10.8	6.4	-6.4	-3.6	-3.0	-2.2	-1.4	3.3	-2.6	-6.6	-6.2	-1.7
Value of the U.S. Dollar (Trade-Weighted)	114.2	108.3	105.0	104.0	103.2	102.6	102.3	100.3	138.3	143.2	111.8	103.0	97.8
Percent Change	-16.5	-19.1	-11.8	-3.8	-3.0	-2.4	-1.1	-7.4	10.4	3.5	-22.0	-7.8	-5.0
Flow of Funds (NIA Basis)													
(Billions of dollars,saar)													
Sources:(total:gross savings)													
Private Saving	719	661	663	685	681	685	696	746	675	688	689	687	757
Personal Saving	153	88	108	118	113	107	110	139	169	143	124	112	136
Savings Rate	5.1	2.9	3.6	3.9	3.7	3.4	3.5	4.3	6.3	5.1	4.2	3.6	4.2
Gross Business Savings	566	573	555	567	568	577	586	608	506	544	566	575	621
Federal Deficit	-238	-197	-189	-189	-182	-183	-198	-219	-170	-198	-207	-188	-221
State & Local	59	62	62	59	56	53	50	49	69	62	63	54	49
Net Foreign Investment	-143	-145	-145	-153	-157	-154	-150	-143	-91	-115	-140	-153	-141
Uses (total:gross investment)	687	675	688	710	706	704	695	716	662	661	690	704	723
Nonresidential Investment	457	457	459	459	455	454	452	452	422	461	458	455	453
Structures	133	130	129	130	130	130	130	130	141	152	135	130	130
Equipment	324	327	329	329	325	324	322	322	281	309	323	325	323
Residential Investment	193	196	195	193	190	189	190	190	171	177	192	191	191
Inventory Investment	15	-5	3	20	17	12	0	15	59	9	13	13	11
Selected Interest Rates (%)													
Mortgage Rates													
30-year Fixed Rate Mortgage	9.9	9.9	9.8	9.6	9.3	9.1	9.0	8.9	13.8	12.2	10.0	9.3	8.7
Real Mortgage Rate	4.4	4.6	4.7	4.9	4.9	5.1	5.3	5.4	6.4	5.5	4.5	5.3	5.4
1-year ARM (without buydown)	8.3	7.7	7.5	7.3	7.0	6.8	6.7	6.6	12.6	10.1	8.1	7.1	6.5
Real Mortgage Rate	3.2	2.7	2.5	5.7	2.9	3.0	3.2	3.4	5.2	3.4	2.8	3.1	3.6
Corporate AAA Bond Rate	9.0	8.8	8.8	8.5	8.2	8.0	7.9	7.8	12.7	11.4	9.0	8.1	7.5
Government Bond Rate	7.5	7.4	7.6	7.4	7.0	6.8	6.7	6.7	12.4	10.8	7.8	7.0	6.5
Federal Funds Rate	6.9	6.2	5.8	5.5	5.4	5.2	5.1	5.1	10.2	8.1	6.7	5.3	5.0
3-month T-Bill Rate	6.1	5.5	5.2	5.0	4.9	4.7	4.5	4.4	9.5	7.5	5.9	4.8	4.6
Real 3-month T-Bill Rate	4.3	1.9	3.5	2.0	2.2	1.6	1.6	1.2	5.6	4.2	3.2	2.0	1.4
1-Year T-Bill Rate	6.6	6.0	5.8	5.6	5.3	5.1	5.0	4.9	10.9	8.4	6.4	5.4	4.8
Real 1-Year T-Bill Rate	4.8	2.4	4.0	2.5	2.7	2.1	2.1	1.7	6.1	4.7	3.7	2.5	1.9
Prime Rate	8.6	7.9	7.5	7.3	7.1	6.9	6.7	6.4	12.0	9.9	8.3	7.0	6.2
Discount Rate	6.6	5.8	5.5	5.2	5.0	4.8	4.6	4.8	8.8	7.7	6.3	4.9	4.7

<1> Historical Data courtesy of Coldwell Banker.
<2> FHA Secondary Mortgage Market Rate
<3> Real Interest Rates = Nominal Interest Rates - Expected Rate of Inflation.

Source: Forecast produced using Laurence H. Meyer and Associates' model of the U.S. economy
Assumptions and simulations by Dr. Frederick Flick, Janemarie Mulvey, and Sean Burns

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